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A TRACT ON TAXATION.

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A TRACT ON TAXATION.

TAXATION has been defined by the most of our great economists to be the collection by the State, from its citizens, of such portion of their property as may be necessary for their protection in the full enjoyment of the remainder.

This definition has, it is true, been considered open to criticism by some political philosophers, in that, as its corollary, there may follow a deduction that such portion so taken should bear a uniform ratio in all cases to the remainder. The illustration used to show the weakness of the deduction is that when the five hundred dollars constituting the sole property of a poor man, is taxed, he is deprived of a certain portion of the necessaries of life, whereas the tax levied upon the many like sums forming the fortune of a millionaire, deprives him neither of necessaries of life, nor luxuries, but of a portion of surplus which he can not use in any merely selfish direction.

Be the reasoning correct or not, we, in California, have, under our present Constitution, no power to be captious.

Accepting the principle, then, as the axiom of our revenue law, we may examine further in the path in which it guides us.

1st. *It must be presumed that a properly conducted government will exact the smallest quantity possible of the*

estate of its citizens necessary. The moment an excess is required, such over-exaction is an abuse of power amounting to robbery, no matter how or why carried out.

2d. *There must be a remainder left for the enjoyment of the citizen;* and a proper revenue system will not take more from the taxed property than such property can repair, by reasonable prudence on the part of its owner, before a succeeding demand, either by accretions of interest, rise in value, or advantage of age. When such remainder is diminished year by year faster than the accruing gains can remedy, the revenue system becomes one of bald confiscation. The tax has been levied for protection; but the law has leagued with robbery, and the property is gone. Such confiscation is of daily occurrence. It is so familiar to us that we scarcely notice it. An illustration may be taken in a library, either public or private. Books, in such instance (save exceptionally), deteriorate in value; on the shelves of the purchaser, they lose a large per cent. of their market value; they render no interest; they grow of less value (save to bibliomaniacs) every year. Yet the law steps in, year after year, abstracts a portion, and finally the library is gone—confiscated by its watchman.

3d. *It must be a portion of the property protected that is taken to pay for its protection.* The law may fail in protecting one class of property equally with another. Such failure may render the property so neglected valueless. It has no right to demand that the tax, which should have been earned by more care and energy, and which should have been collected from the estate protected, must be paid from other effects, which needed no guarding, or took less care to maintain it inviolable.

And now comes the serious question as to the initiatory

point to determine what is property and what is not. How shall we commence our list of the wealth of the State?

1st. One way would be to tax all the property in the State, regardless of ownership, save where such ownership might be deemed part of the description. So far as land, and such other estate as might be deemed immovable, bulky personal estate, and the like, there would be no difficulty; but there are, so to speak, certain classes of property not as patent to the eye of the assessor, depending on the *relations* of persons to property and other persons; without physical existence. The old civilians indicated these relations, and expressed them by the phrases *jus in re* and *jus ad rem*—the property or right *in* the thing, and the right *to* the thing; but the thing itself was the aggregate of these rights. Hence, if the thing were taxed, all the persons having rights in and to it were compelled to pay their respective shares for its municipal protection, for their rights only complemented each other in forming the integer for taxation. Take, for example, an acre of land: one man has the fee, if you please; another has the use; another the occupation; a fourth, the security of the land for money paid any of the persons interested. All of these persons together hold the full property in the land; all are reached by a tax upon it; and such tax having been paid by either of the parties in interest, all are permitted to enjoy it. If the tax is not paid, such land must lose out of its substance —its superficies—that much of the contribution required, together with the extraordinary expense of collection. In either case the State receives its contribution, and every interest has properly contributed to its share of the public burden. In California, no distinction has been drawn between a mortgage debt and an unsecured claim, both

being treated as *solvent debts.* The process of reasoning by which the two have been confused, has emanated from the fact that a mortgage has been held to carry no fee. This is true for the purpose of judicial relief; but it is not true when applied to other phases of mortgage condition. A mortgage is not a fee title, nor does it assume to be; but it is a right to property that may, under conditions, become a fee—it controls the fee. It is so treated for partition purposes, in some conditions of the property of decedents, and whenever practical views are taken of property. A man can not logically be said to own property mortgaged beyond its value. He has a fee; but it needs only the entry of proper papers to sweep it from his grasp. He has the right to buy at an imprudent price; but that is a right he can not be supposed to exercise. There is an element of physical property in a mortgage different from the manifestation in a mere due-bill, however solvent the signer of a due-bill may be. The recourse to the real estate must be had before the solvent debtor who has executed the mortgage can be reached. What is a solvent debt? It is something due from a debtor whose financial condition may be deemed as composed of an aggregation of debts and dues, wherein the dues exceed the debts. For legal solvency, the dues must so exceed the debts as to furnish a *present* ability to pay the latter; but for actual purposes and reasoning, the credits must balance the debits.

2d. To tax this aggregation of assets and liabilities would be the second method of arriving at a taxation of all property. Each man represents, as the civilians termed it, a *universitas rerum*—a collection of things. To arrive at the taxable value, one must enter upon both sides of the sheet, strike a balance, and the excess is the taxable estate. A

owes B. a thousand dollars; but A. has two thousand dollars of estate. A.'s taxable value is one thousand dollars. B. has also two thousand dollars of estate in his possession, and his credit side shows as well that sum possessed, as also the interest which he has in A.'s estate, and B.'s indebtedness to C. of five hundred dollars. Hence, B. must pay tax upon three thousand dollars, less his debt, say of five hundred dollars, to C.

In California, we have, by a skill that might seem almost miraculous, managed to combine the errors of both courses into one harmonious system of financial empiricism.

By some specious coloring, the solvent debt has come, by preference, to mean a claim against land, payable only by sale of the land, and dependent even for its *quasi* solvency upon the ability to realize out of the land, and nothing else, ignoring the prominent fact that evidences of debt are not property in the hands of the holder of such evidences, but are the evidence in fact that such holder has parted with the *jus ad rem*—the right *to* the thing subject to taxation. Hence it follows, as a logical sequence, if we would tax the property represented by a solvent debt, we must go back to the maker of such evidence, because to him alone pertains the *jus ad rem.*

The State of California is rising into something like notoriety, if not fame, among the powers of America. The actions of its citizens, its judges, and its legislators have become subjects of criticism in other communities. We are liable to be deemed ignorant or shrewd, sensible or otherwise, upon the records made by our public men.

It will not answer for legislators to act upon erroneous conceptions that might pass unnoticed in the Board of a sparsely settled county. We are liable to be pilloried as a

State to endure the ridicule of our distant rivals through the imperfect logic, the negligent attention, or the bad training of some unfit legislator. Zeal, obstinacy, or egotism on the part of some ambitious statesman, forgetful of the teachings of political economy, may plunge the State into such a sea of embarrassment that it will put her back a decade in her progress, while an enlightened public policy —not measured by expediency, but based on sound legal principles—would put her in the foreground of progressive States.

From an article by David A. Wells on *The Theory and Practice of Local Taxation in the United States*, (Atlantic Monthly), we make the following abstracts:

"It is known to all who have examined the subject, that a hundred years ago or less the law-makers of England entertained very generally the same opinion in regard to the theory of local taxation which is yet popularly received in the United States, namely, that in order to secure exact justice and equality it is essential to attempt to subject all property of the tax-payer—real and personal, tangible and intangible, visible and invisible—to one uniform rate of valuation and assessment. And although it must then as now have been evident to every one on reflection, that in order to do this, it would be necessary to endow the assessors with more than mortal powers of perception, so as to enable them to see what was invisible and measure what was intangible and incorporeal, (debts and credits, for example), and that, in default thereof, this practical application of the theory must result in absurdity and injustice; yet it is curious to note that the change in English taxation, when it came about, was not due to any such process of reasoning on the part of the people, or to any positive enact-

ment on the part of the State, but rather to a series of legal decisions by its courts, which gradually undermined the whole system of British local assessment, until it tumbled down, as it were, imperceptibly, and gradually became replaced from necessity by a theory which approximated more closely to the principle of political economy and the dictates of common sense. * * * *

"So much, then, as preliminary to a circumstance of national importance and interest, to which the writer first asked the attention of the public in an article published some months ago in the columns of the New York *Nation;* and that is, that fiscal history in the Old World, as thus related, is repeating itself in a most curious manner in the United States, and that the abrogation and reform of the unjust and absurd systems of local taxation at present existing in most of the States, and for the effecting of which neither argument nor the lessons of experience have thus far availed anything, is in the process of gradual and certain accomplishment through the decisions of the courts of ultimate appeal and jurisdiction. * * * *

"But any review of recent progress and the history of local taxation in the United States would be imperfect which failed to notice a most able and interesting decision given in May, 1873, by the Supreme Court of California, in regard to the taxation by its State authorities of real-estate mortgages. The question was one that for a considerable time had greatly interested the people of California, and the drift of popular sentiment, outside of San Francisco, seems to have been most unmistakably in favor of their taxation. But how to do it, and at the same time not increase the burden upon the borrower who had mortgaged his land as a security for a loan of capital to improve or stock it, was a

problem that not a little troubled the law-makers in Legisture assembled. One proposition brought forward contemplated a deduction from the amount of land tax of the asseessment on the mortgage; but as the lands of California were found as a rule to be taxed far below their value, and the mortgages for a value far in excess of the assessors' appraisement of the land they covered, it became soon apparent that this scheme was to a greater or less extent equivalent to exempting the land and taxing the mortgage. Another proposition embodied in a bill introduced into the Assembly by a member of the name of Wilcox was to make void all contracts by which borrowers agreed to reimburse lenders in the amount of the mortgage tax; while others again were exceedingly strenuous in favor of trying the pleasing little experiment—which no community having once tried it ever desires to repeat—of providing that the person giving the mortgage should pay the taxes upon it, but be at the same time authorized to deduct the tax from the principal or interest in settling with his creditor. Pending these discussions, however, the Supreme Court, which had the question before it on a suit to which one of the savings banks of San Francisco was a party, rendered a decision, that in virtue of a clause in the Constitution of the State, requiring all taxation to be equal and uniform, the taxation of mortgages was unconstitutional and illegal; inasmuch as to tax a given property and then tax a mortgage on it, which mortgage is not in itself property, but like a deed or a lease, is a species of conveyance or acknowledgment of a conditional interest or right in the property, is not equal and uniform taxation, but an unequal and double tax on the property mortgaged. The importance of this decision, considered as an act reformatory of our popular

theory of local taxation, does not require to be proved and illustrated; but as it is unquestionably a step in advance of any hitherto taken by either our Federal or State courts, and as, by reason of it, not only are mortgages now exempted from taxation in California, but also all promissory notes and other evidences of indebtedness, it is desirable briefly to ask attention to the reasoning by which the Court was led to its conclusions.

"The opinion was given by the Chief Justice Crocket, who, after reviewing the history of the case, is reported to have used the following language:

"'I come now to the point, whether a tax on land at its full value and a tax on a debt for money loaned, secured by a mortgage on the land, is in substance and legal effect a tax on the same property. We all know, as a matter of general notoriety, that almost universally, by a stipulation between parties, the mortgageor is obliged to pay the tax both on the land and on the mortgage. Practically he is twice taxed on the same value, if he has still in his possession the borrowed money to secure which the mortgage was made. The law taxes in his hand both money and land; and by his stipulation he is required to pay tax on the mortgage debt, and also, if the money has passed out of his hands into the possession of some other tax-payer, it is taxed in the hands of the latter, so that the money bears its share of taxation, and the land its share, in the hands of whomsoever they may happen to be.

"'It is very true that a voluntary agreement on the part of the mortgageor to pay the tax on the mortgage debt can not improve its *situs*. The State was no party to the contract, and is not bound by stipulation *inter alias*. The burdens of taxation can not be shifted from those on whom the law im-

poses them by stipulations between private persons; but in the absence of such a stipulation, an inexorable law of political economy would impose upon the mortgageor the burden, in a different form, of paying the tax on the mortgage debt. Interest on money loaned is paid as a compensation for the use of the money, and a rate of interest as agreed on is the amount which the parties stipulate will be the just equivalent to the lender. If, however, by the imposition of a tax on the debt, the government diminishes the profit which the lender would otherwise receive, the rate of interest will be sufficiently increased to cover the tax, which in this way will be ultimately paid by the borrower. The transaction would be governed by the same immutable, inflexible law of trade, by reason of which import duties on articles for consumption are ultimately paid by the consumer, and not by the importer. The rate of interest on money loaned is regulated by the supply and demand which governs all articles of commerce; and the burdens imposed by law in the form of a tax on the transaction, which would thereby diminish the profits of the lender, if paid by him, will prompt him to compensate for the loss by increasing to that extent the rate of interest demanded. *If his money would command a given rate of interest without the burden, he will be vigilant to see that the borrower assumes the burden, either by express stipulation, or in the form of increased interest. This is a law of human nature, which statute laws are powerless to suppress, and which pervades the whole of trade governed by the law of supply and demand.* Nor would the enactment of the most stringent usury laws produce a different practical result. Human ingenuity has hitherto proved inadequate to the task of devising usury laws which were incapable of easy evasion; and wherever they exist they are, and will

continue to be, subordinate to that higher law of trade which ordains that money, like other articles of commercial value, will command just what it is worth in the market, no more and no less. Assuming these premises to be correct, and I am convinced that they are, it results that it is the borrower, and not the lender, who pays the tax on borrowed money, whether secured by mortgage or not; but if secured by mortgage, he he is taxed not only on the mortgage and property, but on the debt which the property represents, and which is held as security for the debt.' * * * *

"From the experience of the past year, as above related, it must therefore be evident, that although public opinion is slow to change, and legislative bodies are unwilling to give the subject careful consideration, yet, notwithstanding, the work of tax reform goes forward; and that the day is not far distant when the theory, that in order to tax equitably it is necessary to attempt to tax everything, will be as completely ignored and scouted from acceptance in the United States as it has been in every country, our peers in wealth, population, and civilization. It is also interesting to note how this record of recent decisions relative to local taxation coincides with and strengthens an observation made by more than one eminent writer on legal ethics and history, namely, that the law of judicial decision is not only absolutely necessary in every free and progressive society, but that it also contributes far more to the full and free development of such society than what may be termed, in contradistinction, the law of statute or legislative enactment; and that, in the action of our courts, as in the instances referred to and others, we are but following the precedents of England, the jurisprudence of which country is, it is well known, based

upon, or rather consists of, a mass of judicial decisions; and that England in turn has followed the precedents of Rome under the republic, when the law-creating function resided for centuries far more in the courts than in any legislative assembly."

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